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No. 90-647

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

C.L. GRIMES,

Petitioner,

v.

CENTERIOR ENERGY CORPORATION,

Respondent.

MOTION OF UNITED SHAREHOLDERS ASSOCIATION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE* AND BRIEF OF UNITED SHAREHOLDERS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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December 20, 1990

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MOTION OF UNITED SHAREHOLDERS ASSOCIATION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*

United Shareholders Association ("USA") respectfully moves the Court for leave to file the attached brief as *amicus curiae* in support of the petition for certiorari in this case.

Written consent to filing of such a brief has been given by the petitioner and has been filed with the Clerk. The respondent, however, has refused consent—on the stated ground that doing so "would not be in the best interests" of the respondent. USA respectfully submits, however, that for its brief to be received would be in the best interests of justice and materially helpful to the Court.

As is set forth in more detail in the proposed brief under "Interest of the *Amicus Curiae*," USA is a nationwide grass-roots organization of 64,000 stockholders, with a record of successful action to protect and

enhance the rights of the American investor; with a particular interest in reform of corporate governance; and with a special interest in the SEC's rules enabling stockholders' proposals for reform to be included in proxy materials and brought before the shareholders for a vote.

From the perspective of its extensive and well-developed interests and experience in the field here involved, USA is in a position to bring to the Court's attention the degree to which the implications of the opinion below transcend the particular stockholder proposal under review, and threaten a broad undermining of the stockholder proposal rules; and is in a position also to discuss in depth the way in which the SEC's customary procedure in stockholder proposal cases confers upon the opinion below a special "leverage" that at first sight it might not appear to have.

USA thus believes that, in the words of Rule 37.1, its brief will "bring relevant matter to the attention of the Court that has not already been brought to its attention by the parties," and hence can be "of considerable help to the Court."

USA takes no position with respect to the particular stockholder proposal here involved.

Respectfully submitted,

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QUESTION PRESENTED

The *amicus curiae* adopts the statement of the question presented in the petition for certiorari.

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BRIEF OF UNITED SHAREHOLDERS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

United Shareholders Association ("USA"), as *amicus curiae*, respectfully urges that the petition for certiorari in this case be granted.

The interpretation which the opinion below in this case has placed on the SEC's stockholder proposal rules is a grave setback to the cause of shareholder democracy. USA respectfully submits that this Court's review and correction of that interpretation is essential. (USA takes no position as to the merits of the specific proposal here involved).

I. INTEREST OF THE *AMICUS CURIAE*

USA is a nonprofit grass-roots organization of individual stockholders, large and small, with 38 local

chapters and a headquarters in Washington, which in the four years since its foundation has grown to a membership of 64,000 individual stockholders in all 50 states. Organized in response to the growing perception that lack of management accountability has spawned an era of bloated, unresponsive corporations characterized by empire-building and bureaucracy, and currently chaired by a former Commissioner of the SEC, it is dedicated to protecting and enhancing the rights of the American investor. Its agenda includes, among other things, the elimination of management schemes such as "greenmail"[1] eliminating, or requiring shareholder votes on, such other abusive schemes as multi-million-dollar "golden parachute" deals[2] and "poison pill" arrangements;[3] and reform of the proxy

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[1] "Greenmail" is the purchase by management of the stock of one shareholder at a premium price and pursuant to an offer that is not available to the company's other shareholders. Greenmail payments eliminate a challenge to management and typically result in sharp reductions to a company's share value.

[2] "Golden parachutes" are severance contracts which guarantee to existing management that if they lose their jobs as a result of a change of corporate control, they will receive payment of a specified amount, usually several times their regular annual compensation.

[3] "Poison pill" plans involve the issuance of rights to buy stock at a discount, which are triggered by the acquisition of a threshold level of stock which has not received the approval of the incumbent board. By diluting the equity and voting rights of an acquiring shareholder, poison pills render uneconomic the acquisition of a controlling interest in a company without approval of the incumbent board. *See Concept Release on Takeovers and Contests for Corporate Control: Advance Notice of Possible Commission Actions*, Exchange Act Release No. 34-23486, [1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,018 (July 31, 1986); SEC Office of Chief Economist, *The Effects of Poison*

voting system to ensure fairness and greater opportunity for shareholder involvement. USA seeks to place stockholder proposals onto corporate proxy ballots, participates in SEC and court proceedings, lobbies in Congress and the states, and conducts educational activities. It publishes an annual "Shareholder 1000" rating of 1,000 of America's largest corporations by their responsiveness to shareholders, and creates an annual "Target 50" program targeting 50 of the country's worst offenders of shareholder rights for direct action in boardrooms and at annual shareholder meetings.

USA has been effective. As is discussed in further detail *infra*, management is generally hostile to stockholder proposals—especially to proposals for reform of corporate governance that might reduce their privileges and perquisites—and even if a stockholder proposal manages to get on the proxy, management usually sees that it is voted down. Nevertheless, in 1990 USA obtained majority votes in favor of shareholder rights proposals at six major companies; secured overall support for its proposals exceeding 35% at 35 targeted companies where votes were recorded; secured agreement by management at six companies to adopt confidential proxy voting in response to shareholder proposals; and secured consideration of proxy proposals on "golden parachutes" at eight companies.

The ability to have a proposal included in proxy materials under the SEC's stockholder proposal rules

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Pills on the Wealth of Target Shareholders (October 1986); SEC Office of Chief Economist, *The Economics of Poison Pills* (March 1986).

is the most potent single weapon in USA's efforts to secure corporate governance reforms of this kind. USA is thus vitally interested in anything that narrows or weakens these rules—as does the opinion of the court of appeals in this case.

II. SUMMARY OF ARGUMENT

The interpretation of the SEC's stockholder proposal rules enunciated by the court of appeals in this case is of broad applicability and will seriously impede the ability of stockholders to have proposals for reform of corporate governance included in proxy materials for stockholders' meetings. Although there is a great deal of stockholder proposal activity before the SEC's staff, because of special procedural peculiarities the stockholder proposal rules have only rarely come before the courts. This confers a disproportionate "leverage" upon the opinion below, emphasizing the appropriateness of this Court's guidance.

III. ARGUMENT

Two aspects of the decision of the court of appeals are particularly important to consideration of the petition for certiorari. One is the very broad and sweeping nature of the principle followed by the court of appeals—far transcending the significance of this particular case. The other is the great "leverage" of this one decision, because of procedural peculiarities which sharply limit the number of court of appeals interpretations of the stockholder proposal rules. Before discussing these, we will put them in context by describing in simplified form what happens under the SEC's stockholder rules when a stockholder offers a

proposal for inclusion in the proxy materials for an annual or special meeting of a corporation.[4]

A. The Stockholder Proposal Process

A qualified stockholder initiates his proposal by asking management to include it and a supporting statement in the proxy materials for the meeting. If management does not wish to do so, it files with the SEC staff a statement of why it contends the proposal falls within one of 13 excluded categories. If the staff disagrees, management usually does not pursue the matter further, and includes the material in the proxy materials, expecting that most proxies will support management against the proposal (see *infra*). If the staff agrees with management, it issues a "no-action" letter advising that it will not recommend that the Commission institute enforcement action against the company if it refuses to include the proposal.

If the staff does that, at this point the stockholder has no further administrative remedies. Appeal to the Commission will be fruitless, for the Commission will decline to construe and enforce its own rules. This singular practice reflects continuing Commission resistance, after more than twenty years, to the decision of the District of Columbia Circuit in *Medical Committee for Human Rights* v. *SEC*, 432 F.2d 359 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972), that a Commission ruling that a proposal need not be included in proxy materials was reviewable in the court of appeals under § 25(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78y. The Commission

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[4] The stockholder proposal rules are described in detail in the Petition, and set forth in full in its Appendix.

obtained a writ of certiorari in that case, but after oral argument it procured vacation of the writ on grounds of mootness. 404 U.S. 403. Subsequently, the District of Columbia Circuit held, in *Kixmiller* v. *SEC*, 492 F.2d 641 (D.C. Cir. 1972), that a staff no-action letter, as opposed to a ruling by the Commission itself, was not reviewable under the Securities Exchange Act. The Commission has accordingly left such matters to the staff ever since.

The stockholder's only recourse, therefore, is a district court action against the company—founded not on any statutory authority, but on the implied right of action derived from *J.I. Case Co.* v. *Borak*, 377 U.S. 426 (1964)—to enjoin dissemination of proxy materials that omit his proposal. Since time is usually short, this generally entails an application for temporary restraining order and preliminary injunction. With supporting papers and any necessary evidentiary hearing, this can be an expensive and somewhat complicated process, and not many of these actions have been brought. And even stockholders who have the resources to get this far will generally give up if they fail to secure preliminary relief at this point.[5]

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[5] The District of Columbia Circuit commented long ago on the undesirability of the practice the SEC has elected to follow, especially from the viewpoint of the small stockholder. "There is also, it seems to us, an independent public interest in having the controversy decided in its present posture [*i.e.*, by way of SEC decision followed by court of appeals review] rather than in the context of a private action against the company. The primary and explicit purpose of section 14(a) is 'the protection of investors,' and the primary means of reaching this goal is through Commission regulation of proxy statements, not through private actions by individual security holders. For the small investor, personal recourse to the Commission's proxy proce-

Now, though the stockholders own the company and in a real sense *are* the company, all too often present-day managements regard them much as medieval kings regarded their citizenry: ignorant and potentially turbulent folk who should stay quiet and let their betters run things. To such managements, stockholders' meetings are charades,[6] and stockholder proposals are irritations at best, if not outright *lèse-majesté*. Such managements are inclined to fight these battles to the last ditch, seizing upon any plausible argument why the proposal falls within one of the 13 exclusions. Moreover, even stockholder proposals that do manage to make it to the proxy materials stand little chance of adoption. In most companies, proxy voting is non-confidential: management knows how every stockholder votes. As a result, many stockholders fear to vote against management, whatever their views as to the merits of a proposal. "[E]mployees are loath to vote against their superiors. Investment analysts may not wish to offend management because it might affect their access to information. Fiduciaries, like banks, insurance companies

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dures without benefit of counsel may well be the only practicable method of contesting a management decision to exclude his proxy proposal. In this situation, . . . it is particularly important that the Commission look carefully at the merits of the shareholder's proposal, and that it do so pursuant to an accurate perception of the Congressional intent underlying the proxy statute. . . . Direct judicial review of Commission proxy decisions is unquestionably the most logical and efficient means of achieving this objective." *Medical Committee for Human Rights* v. *SEC*, 432 F.2d 659, 672 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972)(footnotes and citations omitted).

[6] One leading authority has called them "a kind of ancient meaningless ritual." *A.A. Berle, Economic Power and the Free Society* 7 (1957).

and pension fund managers, must consider their flow of business from corporations. . . ."[7] Bank trust officers in particular fear to jeopardize the bank's relations with the company, and worry that failure to support management may deter other companies from placing their pension funds with the bank.[8]

So though the stockholder proposal rules offer the only presently available path to real shareholder democracy, that path is a difficult and rocky one at best. The principle followed by the court of appeals in the present case makes it more so.

B. The Principle Followed by the Court of Appeals Broadly Undermines the Stockholder Proposal Rules

In the decision below the court of appeals recognized that in promulgating the current version of the "ordinary business" exception to the stockholder proposal rules, the SEC made it clear that "proposals . . . that have major implications . . . [are] considered beyond the realm of a [corporation's] ordinary business activities," so that "only those proposals involving 'business matters that are mundane in nature and do not involve any substantial policy' considerations

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[7] S. Rep. No. 100-265, 100th Cong. 1st Sess. 126n.90 (1987)(views of Senator D'Amato).

[8] See Curzan and Pelesh, *Revitalizing Corporate Democracy: Control of Investment Managers' Voting on Social Responsibility Proxy Issues*, 93 Harv. L. Rev. 670, 687 (1980); *Pozen, Financial Institutions: Cases, Materials and Problems on Investment Management* 13 (1978); *E. Herman, Conflicts of Interest* 28 (1975). Indeed, there exists a so-called "Wall Street Rule," which decrees that if an investment manager disapproves of the position of management he should either "swallow his qualms or sell the stock." Curzan and Pelesh, *supra*, at 686.

may be omitted under [the 'ordinary business'] exemption. . . ." Petition for Certiorari, Appendix ("Pet. App.") at 6a, quoting the SEC's statement at 41 Fed. Reg. 52,998 (1976). But, having enunciated this principle, the court did not inquire whether the proposal before it had "major implications." Rather, it inquired whether the proposal was "limited in reach" *solely* to major implications,[9] and held that if it was not—if it could have *any* minor implications under any hypothetical circumstances—then it fell within the "ordinary business" exclusion no matter how great its major implications might be.[10] As applied by the court in the present case, this produced what the Petition calls the "any subsequent action" test: management can exclude a stockholder proposal for a change in corporate governance from the proxy materials under the "ordinary business" exclusion if there are any circumstances under which an ordinary business action might be taken under the proposed new corporate governance. Petition for Certiorari at 9.

This test would enable hostile management to exclude many, if not indeed the great majority of, pro-

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[9] "[T]he proposal is not limited in reach to those capital expenditure decisions involving substantial policy considerations of very large sums, but potentially extends to capital expenditures of any kind." Pet. App. 7a-8a.

[10] "For example, if in a given year no dividends were paid, all capital expenditure decisions for the following year, no matter how small, would have to be made by the shareholders. In such circumstances, Grimes's proposal would involve them in such minor or routine day-to-day decisions as the purchase of typewriters or the replacement of worn-out machinery. Such decisions would clearly be matters of ordinary business operations." Pet. App. 8a.

posals for significant reform of corporate governance. For example, USA opposes "classified boards," under which directors are elected for staggered terms to forestall clean-sweep replacement of unsatisfactory management by the shareholders. But a proposal to abolish a classified board will evidently be caught by the "any subsequent action" test, since the ordinary business of any corporation is conducted by its board. Again, USA supports confidential proxy voting, to eliminate the abuses that flow from management's knowledge of how every stockholder votes; the extension of this reform is one of USA's "Target 50" goals for 1991. But under the "any subsequent action" test, any effort to put confidential voting on a corporate ballot is likely to be blocked on the ground that one result might be confidential voting on some ordinary business matter. These are but two examples, drawn from USA's current agenda, of many that might be offered.

But there is a wider ground for concern. The reasoning behind the "any subsequent action" test applied by the court of appeals is not only broader than its application to the particular proposal here involved; it extends potentially to other situations than a "subsequent action" and other exemptions besides that for "ordinary business." The court's basic reasoning is that a proposal must be "limited in reach" solely and exclusively to matters that fall totally outside the 13 exclusions, and that if under any set of hypothetical circumstances some connection can be made between the proposal and one of the 13 exclusions, then the proposal is exempt and can be omitted by management. On this logic, a proposal for confidential proxy voting could arguably be excludable un-

der the exemption for proposals that relate to an election to office.[11] On this logic, since one side effect of a "poison pill" plan will be to dilute the dividends of existing shares in proportion to the amount of new stock issued, a proposal requiring shareholder approval of such plans could be excludable under the exemption for proposals dealing with specific amounts of dividends.[12] Such an interpretation of the stockholder proposal rules is diametrically opposed to their remedial intent and spirit, and USA does not suggest that such interpretations would ultimately be adopted. But they illustrate the kind of obstacles to corporate reform which the reasoning of the court of appeals affords to any management resolved upon a last-ditch defense.

C. This Court Should Exercise Its Authority Because of the Special and Peculiar "Leverage" of the Decision Below

Though the stockholder proposal rules have been on the books in some form since 1942, USA has found only five other reported cases in which they have been addressed by the courts of appeal,[13]plus five more

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[11] A proposal is exempted "if the proposal relates to an election to office." SEC Rule 14a-8(c)(8), 17 C.F.R. § 240.14a-8(c)(8).

[12] A proposal is exempted "if the proposal relates to specific amounts of cash or stock dividends." SEC Rule 14a-8(c)(13), 17 C.F.R. § 240.14a-8(c)(13).

[13] *Rauchman* v. *Mobil Corp.*, 739 F.2d 205 (6th Cir. 1984); *Jansky* v. *Miller*, 474 F.2d 365 (9th Cir. 1973); *Kixmiller* v. *SEC*, 492 F.2d 641 (D.C. Cir. 1972); *Medical Committee for Human Rights* v. *SEC*, 432 F.2d 659 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972); and *Dyer* v. *SEC*, 290 F.2d 541 (8th Cir. 1961), 289 F.2d 242 (8th Cir. 1961), 266 F.2d 33 (8th Cir. 1959).

apparently unappealed reported district court cases;[14] none of which offers any significant substantive interpretation. USA recognizes that ordinarily this would militate against grant of certiorari, on the ground that the topic was of limited interest, or was one as to which the courts of appeals should be let alone to explore its implications before this Court steps in.

Here, however, appearances are deceiving. The paucity of court decisions under the stockholder proposal rules reflects only the exceptional procedural aspect of these cases, described at pp. 5-7 *supra*, under which the SEC leaves them to the staff and very few of them reach even the district courts, much less the courts of appeal. This does not mean the topic is not a lively one. For by contrast, entries for staff actions under those rules cover some eight pages in the relevant CCH volume, Fed. Sec. L. Rep. (CCH) ¶ 24,151.80 at 17,691-14 to 17,691-21, embracing perhaps 150 such actions; and Lexis reports a total of no less than 4,537 staff letters since 1971 which appear to deal with stockholder proposals.[15] Under these circumstances, the paucity of court decisions in this

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[14] *New York City Employees' Retirement System* v. *American Brands, Inc.*, 634 F.Supp. 1382 (S.D.N.Y. 1986); *Lovenheim* v. *Iroquois Brands, Ltd.*, 618 F.Supp. 554 (D.D.C. 1985); *Mougios* v. *W.R. Grace & Co.*, 52 F.R.D. 576 (S.D.N.Y. 1971); *Brooks* v. *Standard Oil Co. (New Jersey)* , 308 F.Supp. 810 (S.D.N.Y. 1969); *Peck* v. *Greyhound Corp.*, 97 F.Supp. 679 (S.D.N.Y. 1951).

[15] This is the number of items reported by Lexis in its NOACT file under GENFED and FEDSEC, searched for "14a-8" and "proposal" and "stockholder or shareholder." Because of their great number USA has not examined all these individually and accordingly cannot represent that all constitute rulings on individual stockholder proposals. But it is very evident in any case that the subject-matter is an extremely active one.

otherwise busy field actually makes this Court's intervention more appropriate rather than less, for it confers an extraordinary "leverage" on the decision below which it would not otherwise have.

Given the extraordinary importance of the stockholder proposal rules to corporate democracy and to badly-needed reform of corporate governance, American stockholders deserve more guidance than the illogical decision of the court below in this case and the *ad hoc* views of harassed middle-level administrative staff—which are "considerably less authoritative" than would be "the definitive views of an agency head."[16] Under present circumstances, stockholders can only get such guidance from this Court. The situation is thus eminently appropriate for exercise of this Court's certiorari jurisdiction.

IV. CONCLUSION

The decision below has broad implications. The topic dealt with is one of fundamental importance. The guidance of this Court is badly needed. The petition for certiorari should be granted.

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[16] *Kixmiller* v. *SEC*, 492 F.2d 641, 644n.13 (D.C. Cir. 1974).

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